Non-Confidential

6 May 2021

Northern Ireland Assembly, Committee of Justice

Damages (Return on Investment) Bill

IFoA Response

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

The Institute and Faculty of Actuaries (IFoA) is clear that the needs of injured parties should be at the centre of any compensation paid as their needs may be greatest. We also support the principle that settlements should aim to provide 100% compensation, but neither more, nor less.

The investment needs of injured parties - and their attitude to risk - may differ from those of the wider population, as a result of suffering a life-changing injury. The proposed methodology assumes a personal injury claimant invests a lump sum compensation in a mixed portfolio of low-risk investments. However, our view is that the discount rate should be derived from a risk-free rate of return, reflecting the risk appetite of a risk-free investor. Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate increases this risk. The variability arising from investment returns may provide additional assets for some claimants but for other claimants, poor outcomes may lead to insufficient assets for the later years of life.

Moreover, whichever methodology is used to set the discount rate will not ensure 100% compensation, even if it the aim is to achieve 100% compensation on average. Individuals will live either longer or shorter than expected, which may then lead to under- or over- compensation as applicable. Aiming to assure full compensation to the majority of claimants would require a bias towards over-compensation.

We believe that it could be difficult to access data on actual investment of lump sum awards, and so it is sensible instead to consider a notional investment portfolio. We also note that the notional portfolio high-level asset allocation is identical to that used in setting the equivalent discount rate in Scotland. Having consistency in this respect is not unhelpful, as we would not expect investment decisions by personal injury claimants in Northern Ireland to differ materially from those made by claimants in Scotland.

We support the use of the longer investment period (i.e. 43 years instead of 30), in determining the discount rate. It is not uncommon for a lump sum settlement to be provided to claimants in their 20s and 30s, with a corresponding need for care for the rest of their lives. In these circumstances, a 30 year term would be insufficient.

We support the principle of transferring responsibility for setting the rate to the Government Actuary on the grounds of transparency. It should also mean that setting the rate should be free of political pressure.

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1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Northern Ireland Assembly Committee of Justice's questions on the Damages (Return on Investment) Bill [1]. We thank the Committee clerks for the extended opportunity to respond to the Committee's questions. We hope the Committee find our responses helpful.

2. Members of the IFoA's General Insurance Standards and Consultations sub-Committee input to this response. Members of our sub-Committee have worked closely on personal injury claims over the last decade.

3. Before turning to the questions raised, we have some general comments to make in the first instance.

General Comments

4. The IFoA is clear that the needs of injured parties should be at the centre of any compensation paid. We also support the principle that settlements should aim to provide 100% compensation, but neither more, nor less.

5. It is important to note that, as for any IFoA response, we have considered the PRA's proposals from an independent, public interest perspective. We have interpreted the public interest in this context to be the requirement to provide the claimant with 100% compensation.

6. For the questions raised, the IFoA are not in a position to provide quantitative evidence; for some of these questions, other parties may be better-placed to provide a suitable evidence base. However, where possible we have made some qualitative points which we hope are helpful.

Is the new statutory methodology to calculate the personal injury discount rate the most appropriate to achieve as close to 100% compensation as possible?

Has the new methodology the potential to veer towards over compensation and if so how can this be rectified?

Has the new methodology the potential to veer towards under compensation and if so how can this be rectified?

We have considered these questions together.

7. As mentioned above, the IFoA supports the intention to achieve as close to 100% compensation as possible. We also believe the needs of the injured party should be central to any compensation paid, as their needs may be greatest. We note further that the investment needs of injured parties - and their attitude to risk - may differ from those of the wider population, as a result of suffering a life-changing injury.

8. The proposed methodology assumes a personal injury claimant invests a lump sum compensation in a mixed portfolio of low-risk investments. Our view however is that the discount rate should be derived from a risk-free rate of return, reflecting the risk appetite of a risk-free investor. Lump sum settlements expose claimants to uncertainty over the adequacy of their compensation, and using a higher discount rate increases this risk. It is also important to recognise that individuals have differing appetites to risk. Low or very low risk for one individual may mean something different to someone else, and such differences in appetite will result in different investment decisions. The variability

[1] Questions set out in Christine Darrah's letter to James Harrigan (IFoA), dated 26 March 2021.

arising from investment returns may provide additional assets for some claimants but for other claimants, poor outcomes may lead to insufficient assets for the later years of life.

9. In addition, under Solvency II (the EU-wide insurance regulatory framework), insurers are required to discount Periodical Payment Order (PPO) [and other] liabilities at a risk-free rate. This is inconsistent with the discount rate setting methodology proposed for personal injury lump sums. *PPOs often being offered as an alternative to lump sum compensation in personal injury claim settlements*.

10. As the Committee may realise, whichever methodology is used to set the discount rate will not ensure 100% compensation, even if it the aim is to achieve 100% compensation on average. Individuals will live either longer or shorter than expected, which may then lead to under- or over- compensation as applicable.

11. Aiming to assure full compensation to the majority of claimants would require a bias towards over-compensation. We note the proposed additional 0.5% deduction from the derived discount rate, with the aim to reduce the risk of under-compensation. We are not in a position to comment on the effectiveness of this deduction in reducing the likelihood of under-compensation.

Does the new statutory methodology reflect how a claimant would be advised to invest their award?

12. We believe that it could be difficult to access data on actual investment of lump sum awards, and so it is sensible instead to consider a notional investment portfolio.

13. We also note that the notional portfolio high-level asset allocation is identical to that used in setting the equivalent discount rate in Scotland. Having consistency in this respect is not unhelpful, as we would not expect investment decisions by personal injury claimants in Northern Ireland to differ materially from those made by claimants in Scotland (or England and Wales). Claimants in Northern Ireland are exposed to a similar investment market in terms of asset types, scale, access to financial advice and expenses, as well as sharing a common currency.

What are the likely effects of using an investment period of 43 years rather than 30 years in the model and do you agree with this approach?

14. We support the use of the longer investment period (i.e. 43 years instead of 30), in determining the discount rate. It is not uncommon for a lump sum settlement to be provided to claimants in their 20s and 30s, with a corresponding need for care for the rest of their lives. In these circumstances, a 30 year term would be insufficient. However, we do note that the longer investment period may be more likely to under-compensate individuals with shorter life expectancy.

What are the advantages or disadvantages of transferring responsibility for setting the rate from the Department of Justice to the Government Actuary and is there an appropriate level of accountability in the new statutory methodology?

15. We support the principle of transferring responsibility for setting the rate to the Government Actuary on the grounds of transparency; the Government Actuary could seek independent consultations for future changes, and their work should be subject to peer review. The transfer of responsibility should also mean that setting the rate should be free of political pressure.

16. We would welcome the opportunity to discuss our response with the Committee for Justice in more detail, or to provide any wider insight into public injury claim compensation, if that were if value to the Committee.

Should you want to discuss any of the points raised please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham

Technical Policy Manager
On behalf of Institute and Faculty of Actuaries